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ABSTRACT

Cost benefit analysis may in the future become a valuable tool for management in higher education, provided the benefits of acquiring a body of knowledge can be defined. Since higher education is not subject to the disciplines of the marketplace in the sense that private business is, we need to find other reasons for influencing our decisions on the effective use of resources and the benefits derived. Just staying in the black at year-end is not a sufficient measure of successful financial management. The full costs of programs and the benefits derived from these programs must be analyzed. (Author/MJN)

NATIONAL COST STANDARDS - FOR WHAT PURPOSE?

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*Remarks prepared for delivery 2:30 p.m., Thursday, July 11
"Analyzing the Report from the National Commission
on the Financing of Postsecondary Education"*

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One of the charges to the National Commission on the Financing of Postsecondary Education given by Congress was to recommend national uniform standards which could be used to determine the annual per-student costs of providing postsecondary education for students in attendance at various types of institutions of higher education. This particular charge was an extremely difficult assignment for the Commission to carry out in the time frame allowed by Congress.

In my opinion, the charge had two major parts: the first involved the development of national cost standards; and the second involved the development of cost measuring techniques. My comments are directed to the first part of the charge, namely, the establishment of national costs standards. It seems to me that the second part, that of measuring costs of higher education, cannot be accomplished until acceptable cost standards have been established and accepted by professionals in the field of higher education finance.

Before I delve into the subject of the purpose of cost standards, let me share with you a little background about the final report of the Commission. The portion of the Commission's 442 page report which pertains to national uniform standards on costing is a chapter consisting of 19 pages and entitled "National Standard Procedures for Institutional Costing and Data Reporting." In this chapter, a footnote refers to a staff paper as the recommended "Interim National Standard Procedures for Deriving Per-Student Costs in Postsecondary Educational Institutions." The staff paper consists of 34 pages of explanation of the interim cost procedures, with 80 pages of descriptions and classifications similar to those developed by NCHEMS.

The recommendations of the Commission pertaining to this portion of the report are paraphrased as follows:

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1. The federal government should provide continuing leadership in encouraging and developing national standard procedures.
2. Interim national standard procedures for calculating these costs-per-student should be adopted by the federal government to be implemented by institutions on a voluntary basis.
3. Federal support should be provided for the development and reporting of financial and program data to supplement and extend the cost-per-student data.
4. The federal government should ensure that the data base assembled by this Commission is updated, maintained, and made available to appropriate public and private agencies.
5. The federal government should support a national center for educational information.

After receipt of the Commission's report by the NACUBO Cost Studies Committee, it was reviewed along with the footnoted staff report. The results of the review were submitted to NACUBO headquarters and later forwarded to the U. S. Commissioner of Education.

It was found that the Commission's report pertaining to costing has some of the same weaknesses that other reports of this type have had over the past 20 years, namely, methods of measuring costs are recommended in advance of identifying what the cost standards and principles should be in accumulating and reporting costs. I suppose the best analogy of this problem would be the attempt to produce a financial report without first having established accounting standards and principles as a basis for preparing the report.

With this background information, let me now focus the remainder of my remarks on National Cost Standards - For What Purpose? I think that most of us here would agree that it is vitally important for management in higher education to have access to meaningful cost information about its operations. Rather than institutions going off in separate directions to develop costs, surely it is more beneficial to have a concerted costing effort by all institutions. To accomplish this requires the establishment of cost standards and principles which can be used by each institution. Standards, as used here, mean a statement of principles to be followed and practices to be applied. This meaning is consistent with the interpretation of standards provided by the federal Cost Accounting Standards Board.

Standards are used to determine what to include in costs; they do not necessarily pertain to standards of arriving at per-student costs. Standards are important because they establish the framework in which costing principles can be applied and, of course, they must be consistent with generally accepted accounting principles. In establishing standards, consideration should be given to the variety of cases and circumstances that exist in higher education. Validity and reliability of the results are additional factors to consider. The question will inevitably arise: Is it

necessary to have results that are 100 percent valid and reliable, or can we live with 95 percent or 90 percent? In my opinion, we may never achieve 100 percent validity from reports of faculty activities and time distributions. This problem in and of itself may not matter, but the degree of validity does matter.

I doubt that any institution wants to go to the trouble of developing cost information and then have the results disputed, as has been the case so often in the past. We need to know in advance the best principles of costing to apply and then proceed with the task of determining costs. The application of standards should be done consistently and uniformly. Arbitrariness in allocating costs is not defensible. I don't think that any of us want to fall into the trap of having to live by rules that are established after the fact.

The federal Cost Accounting Standards Board described cost standards as "guides to action." Standards provide a criterion for eliminating costing alternatives that are unsound and weak in terms of their justification of cost accumulation and allocation within a conceptual foundation of cost accounting theory. Cost standards are deemed to be uniform when the goal of reliability and consistency of significant data has been achieved. Cost standards, in their broadest sense, embrace the related principles, standards, and general rules or procedures along with the criteria for their usage. They assure the elimination of unsound accounting treatments.

For those institutions with sponsored research contracts, it is essential to know the cost assumptions of performing the contract. Without standards, there is no clear and consistent way to allocate cost to contracts. This is not to say that without standards invalid ways are used for allocating costs to contracts. It does mean that the establishment of cost standards eliminates the accounting differences that can take place. Standards produce clearer ways of saying things, and they eliminate ambiguities and the possibility of double charging.

There are indeed other purposes for having national cost standards. If an institution is involved in planning for the future allocation of its resources, it is important to know the present cost of doing business as well as the future costs. Management in higher education is constantly attempting to make cost improvements in order to better utilize its resources. Management needs to be able to make internal cost comparisons from year to year and, in certain instances, to make external cost comparisons with comparable institutions.

In this era, private institutions in particular are confronted with the realities of survival. Knowledge about the cost of doing business is an essential ingredient for survival as well as for planning for the future. If an institution does not know the full costs of operating a program, then surely it is difficult to decide whether to increase, decrease, eliminate, or hold the status quo in terms of available resources.

Without accurate cost information, how can an institution really improve its operating efficiency and place a value on the improvement? Internally, many of us still have not uniformly identified our direct and indirect costs nor our variable and fixed costs. If salaries of tenured faculty are fixed costs, then we all should know how much and how long.

Cost/benefit analysis may in the future become a valuable tool for management in higher education, provided we can adequately define the benefits of acquiring a body of knowledge. Since higher education is not subject to the disciplines of the market place in the sense that private business is, we need to find other reasons for influencing our decisions on the effective use of resources and the benefits derived. Just staying in the black at year-end is not a sufficient measure of successful financial management. We need to look at full costs of programs and the benefits derived from these programs. Hence, another important reason for cost standards in higher education -- namely, to relate costs to benefits.

Externally, national cost standards are also important. Many institutions are involved in state-wide planning where disclosure of full costs is required or will be required. Additionally, management is being forced to make external comparisons of costs, especially between competing institutions, in establishing tuition rates, housing rates, and so forth. Some institutions may be contemplating new programs, and cost comparisons with comparable institutions can be most helpful in making a decision to implement, partially implement, or scratch the proposed new program. Stating it another way, it usually turns out that some information is better than none, unless the information is deliberately misleading.

Some people go so far as to say that higher education has a social responsibility to know the elements of its full costs of operation in order to help keep the charges to the students and parents as low as possible. Others claim that a fiduciary responsibility exists for management to use its resources in the most effective way possible. All of the concerns relate to the need and purpose of national cost standards.

Let me now briefly turn to what NACUBO could do in terms of establishing and implementing national cost standards. First, I would like to provide some examples of cost standards which might be considered applicable to higher education as follows:

1. Consistency in accumulating and reporting costs. This is related to but not the same as the information in annual financial reports. It would involve the classification of elements or functions of cost as direct or indirect. It would also include the establishment of indirect cost pools to which each element or function is charged.
2. Consistency in allocating costs incurred for the same purpose. This standard would involve the assurance that costs are allocated only once and on only one

basis to any cost objective. If some cost items are accounted for as direct costs, they should not also be included as indirect costs.

3. Allocation of costs to cost objectives on an equitable and fair basis. This would involve the consideration of materiality and reasonableness as well as sound accounting principles.

These standards are not all inclusive nor are they expected to dictate only one accounting alternative for all circumstances. Accounting alternatives can and must be given for unique circumstances where this proves necessary.

Perhaps NACUBO can help by working for the establishment of a Cost Standards Board for Higher Education with broad representation from higher education, the federal government, and the American Institute of Certified Public Accountants. Along these same lines, the Cost Studies Committee has prepared a grant proposal which, if funded, would see that cost standards for higher education are established. Once this is accomplished, we can then proceed with the task of uniformly accumulating cost information. And finally, as previously mentioned, the next major effort would be to develop meaningful ways to measure these costs.

In concluding, I would like to leave you with this thought. Management decisions will always depend, in the final analysis, upon the exercise of judgment, and judgment is usually formed on the basis of available information. If information on full costs of operating an institution is not available, judgments will be made without the benefit of cost information. Few business enterprises would attempt to operate and make decisions without the benefit of cost information. Isn't it time we in higher education developed cost standards and obtained cost information in a uniform and consistent manner?